Legal Profession Act 2004 **(NSW) – costs agreement between law practice and client – whether binding on non-associated third party payer - GST implications when client entitled to input tax credit**

The decision in the New South Wales Supreme Court in *Boyce v McIntyre* [2008] NSWSC 1218 involved determination of a number of issues relating to an assessment of costs under the *Legal Profession Act 2004* (NSW) ("the Act").

One issue of broad significance was whether a non-associated third party payer must pay the fixed fee that was agreed between the law practice and the client. The court found that the client agreement did not form the basis of assessing costs for the non-associated third party payer.

The case also involved consideration of whether GST should be included in the assessment in the circumstances of the case.

This note will be restricted to the consideration of these two issues only.

Background facts

Kosciuszko Thredbo Pty Ltd ("KT") leased land from the State of NSW in the Kosciuszko National Park. Mrs McIntyre was one of some 675 sub-lessees from KT. Her original sub-lease expired on 24 June 2007, but it contained an option to renew. The head-lease of KT itself expired on 27 June 2007 but was renewed for a further period of 50 years commencing 28 June 2007. All of the sub-leases, which expired just prior to the head lease, contained an option to renew.

The law firm Cutler Hughes & Harris ("CHH") acted for KT in relation to the renewal of the sub-leases.

CHH and KT entered into a costs agreement covering the legal services CHH provided to KT in relation to the renewal of the sub-leases. The costs agreement provided for a fixed fee of $3,000 plus GST for each sub-lease. The sub-leases contained provisions requiring the sub-lessees to pay KT's "reasonable legal costs" of or incidental to the preparation, completion, stamping and registration of the sub-lease or any renewal of the sub-lease.

Mrs McIntyre was notified of the proposed process for the exercise of the option to renew by letter from CHH. It included the estimated legal fees for the renewal at approximately $3000, plus GST and disbursements. Mrs McIntyre returned a "Notice of Exercise of Option" and a new sub-lease commenced on 29 June 2007. Subsequently, CHH sent invoices to Mrs McIntyre and KT

totalling $3502: $3000 for professional costs, plus $300 for GST and disbursements of $202. Mrs McIntyre applied to have these costs assessed.

Costs assessment and review

The costs assessor regarded Mrs McIntyre as a “non-associated third party payer” as defined in s 302A of the Act (terms relating to third party payers) as she was under a legal obligation to pay all the costs for legal services provided to KT in preparation of the sub-lease. She fell into the category of non-associated third party payer as defined by the same section because her legal obligation was to KT but not to CHH.

The costs assessor proceeded on the basis that in these circumstances the costs agreement made between KT and CHH was not binding on Mrs McIntyre. Accordingly the costs assessor did not apply s 361 of the Act (assessment by reference to costs agreement) but stated that the costs were to be determined according to s 363 of the Act (criteria for costs assessment).

After considering the factors in s 363 of the Act, the costs assessor concluded that the fair and reasonable amount of the costs of CHH was $2050. No amount was included for GST, The disbursements of $202 were not challenged thus the total costs payable was $2252. However, the costs assessor decided there should be a deduction of $1200 from this amount relating to the costs of Mrs McIntyre for the assessment itself. The formal determination of the amount payable "to the Costs Respondent" was $1052.

On 7 March 2008, the costs review panel affirmed the assessment.

By summons filed 3 April 2008 CHH appealed, in reliance on both s 384 (appeal against decision of costs assessor as to matter of law) and 385 (appeal against decision of costs assessor by leave). The orders sought included:

- orders setting aside the determinations of the costs assessor and the costs review panel;
- a declaration that s 361 of the Act applies to an application for assessment under s 350(2) of the Act by a “non-associated third party payer” [Section 350 (Application by client or third party payers for costs assessment) enables clients to apply for an assessment of legal costs, and also gives third party payers a right to apply for an assessment of the whole or part of legal costs payable by the third party payer];
- leave to appeal the review determination and the assessor’s determination under s 385 of the Act; and

- a determination that the costs be assessed at $3502 or, in the alternative, that the first defendant's application for assessment be remitted to an assessor to be determined according to law.

Legislation

The judgment of Harrison AsJ includes a detailed consideration of the statutory framework of the Act in relation to costs disclosure and assessment under Part 3.2. The judge focused in that context on the third party payer provisions, which were introduced into the Act by the *Legal Profession Further Amendment Act* 2006 (NSW).

Sections 322 and 361 are especially relevant to the main issue in dispute. Section 322 of the Act provides, so far as is relevant:

> **322 Making costs agreements**
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> (1) A costs agreement may be made:
> (a) between a client and a law practice retained by the client, or
> (b) between a client and a law practice retained on behalf of the client by another law practice, or
> (c) between a law practice and another law practice that retained that law practice on behalf of a client, or
> (d) between a law practice and an associated third party payer.
> …
> (6) A reference in section 328 and in any prescribed provisions of this Part to a client is, in relation to a costs agreement that is entered into between a law practice and an associated third party payer as referred to in subsection (1) (d) and to which a client of the law practice is not a party, a reference to the associated third party payer.

Section 361 of the Act provides:

> **361 Assessment by reference to costs agreement**
>
> (1) A costs assessor must assess the amount of any disputed costs that are subject to a costs agreement by reference to the provisions of the costs agreement if:
> (a) a relevant provision of the costs agreement specifies the amount, or a rate or other means for calculating the amount, of the costs, and
> (b) the agreement has not been set aside under section 328 (Setting aside costs agreements),
> unless the assessor is satisfied:

(2) The costs assessor is not required to initiate an examination of the matters referred to in subsection (1) (c) and (d).

(c) that the agreement does not comply in a material respect with any applicable disclosure requirements of Division 3 (Costs disclosure), or

(d) that Division 5 (Costs agreements) precludes the law practice concerned from recovering the amount of the costs, or

(e) that the parties otherwise agree.

Did the review panel err in law in finding that s 361 of the Act did not apply to the application?

CHH submitted that both the costs assessor and the review panel erred in law in proceeding on the basis that s 361 was not applicable in the circumstances, and determining costs according to s 363 of the Act (criteria for costs assessment).

Harrison AsJ said that she should approach the questions before her on the basis that the primary objective of statutory construction is to construe the relevant provisions so that they are consistent with the language and purpose of all the provisions of the statute: *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355.

She referred to the definition of legal costs in s 4 of the Act as meaning: "amounts that a person has been or may be charged by, or is or may become liable to pay to, a law practice for the provision of legal services including disbursements but not including interest." She found that the costs here did not fall within that definition because Mrs McIntyre was not liable to pay a law practice for the provision of legal services, but rather was obliged to pay KT.

Further, the judge noted that although a costs agreement may be made between a law practice and an associated third party payer under s 322(1)(d), s 322 did not envisage any costs agreement between a law practice and a non-associated third party payer. She said this made sense, because there was no association between the law practice and the non-associated third party payer.

In the judge's view, the reference to costs agreement in s 361 should be construed as a reference to a costs agreement envisaged by s 322. This meant that s 361(1) could apply to a costs agreement made between a law practice and an associated third party payer, but that it did not apply to an assessment on application by a non-associated third party payer.

The judge found support for her construction of s 361 in the provisions of the Act relating to party/party costs. She noted in that context that a costs agreement between the successful party and its law firm may be taken into

account by the costs assessor, but is not to be binding on the unsuccessful party: s 365.

The conclusion was that the costs review panel was correct in its determination that s 361 did not apply, and did not impose a fixed costs agreement between a law practice and a client on a non-associated third party payer.

Did the review panel err in law in determining that GST should not be included in the amount assessed?

The review panel confirmed the determination of the costs assessor on GST that GST should not be included. The assessor had concluded that GST could not be claimed. He emphasised that KT as sub-lessor had an input credit and the relevant costs were the costs of acting for the Sub-lessor, who had primary liability to pay them, even though there was a contractual requirement on Mrs McIntyre to make the payment.

CHH submitted that the assessment could only relate to "legal costs" payable by Mrs McIntyre, and that an assessor could not determine any GST liability sought to be recovered from her under the sublease any more than an assessor can determine any entitlement to recover electricity or rate charges.

Mrs McIntyre submitted that the assessor and the review panel were satisfied on the material before them that KT was conducting an enterprise, was registered for GST and that the supply of legal services to it by CHH was a taxable supply including GST. She submitted that KT was entitled to an input tax credit for the GST component to the plaintiff's bill of costs. Since Mrs McIntyre's liability to pay the reasonable costs of KT was in the nature of a partial indemnity created by the terms of the sublease, she submitted that she was not liable to pay GST.

Harrison AsJ accepted the submissions for Mrs McIntyre and found there had been no error of law.[1]

Orders

The court refused leave to appeal, dismissed the appeal, and affirmed the decision of the costs review panel.

Comment

Though this decision construes provisions of the *Legal Profession Act 2004* (NSW), the corresponding provisions of the *Legal Profession Act 2007* (Qld) are in essence the same. In particular, s 322 of the Queensland Act (making costs agreements) mirrors s 322 of the New South Wales Act, and s 340 of the

Queensland Act (assessment of complying costs agreement) mirrors the terms of s 361 of the New South Wales Act.

This appears to be the first court decision on provisions relating to non-associated third parties. It might be expected to be seriously considered in Queensland and is accordingly significant for any area of practice in which in the ordinary course legal costs are passed on to non-associated third parties, such as lessees, mortgagors and joint venture members.

[1] The conclusion that no GST component should be included in the assessment may warrant further consideration in the future. It might be noted in that context that it did not involve any analysis of the precise terms of the sublease between KT and Mrs McIntyre. It was those contractual terms which created the obligation on Mrs McIntyre to pay the legal costs and governed the extent of her obligation, rather than any provisions in the *Legal Profession Act* 2004 (NSW). The applicable principle in such circumstances was explained in *Jamieson v Gosigil Pty Ltd* [1983] 2 Qd R 117. The assessment also appeared to assume without explanation that no GST was payable in relation to the payment by Mrs McIntyre. Is the position different to that where a court makes an order for costs in favour of a party as distinct from where a party makes a payment to another as re-imbursement for some or all costs in a commercial transaction?